Background Paper: Basel Implementation in Low and Lower-Middle Income Countries – Early Adopters of Basel III[1]

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The Global Economic Governance Programme is directed by Ngaire Woods and has been made possible through the generous support of Old Members of University College. Its research projects are principally funded by the Ford Foundation (New York), the International Development Research Centre (Ottawa), and the MacArthur Foundation (Chicago).

[1] This research was funded by the Ford Foundation as part of the Global Economic Governance Programme's research on global financial governance. Thank you to Emily Jones, Ngaire Woods, Thorsten Beck, Alexandra Zeitz, Nina Obermeier and the Global Economic Governance Research Discussion Group for their guidance and comments. Any errors are my own.

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Summary

Introduction

In 1988, the Basel Committee on Banking Supervision, a body devoted to regular cooperation between members on financial regulation, agreed global financial standards known as the Basel Accords. The purpose of the accords is to ensure that financial institutions have enough capital on hand to meet their obligations and to absorb unexpected losses, including those arising from systemic risks. The standards are non-binding in nature. Basel Committee members negotiate them and agree voluntarily to implement and comply with them. The standards do not create any obligations on non-members. While the Basel Committee originally included only the Group of Ten countries,[3] it now includes 27 countries: G-20 members and other banking centres.[4] The Committee has published three iterations of the accords, Basel I in 1988, Basel II in 2004 and Basel III in 2010. Basel III seeks particularly to respond to supervisory gaps revealed by the global financial crisis.

Data collected by the Financial Stability Institute (**FSI**) shows that many non-member States, including low and lower-middle income countries (**LICs** and **LMICs**), are implementing elements of the Basel standards, despite having no obligation to do so. Academics have not yet systematically examined this phenomenon. In particular, there exists virtually no research on the mechanisms for adoption of Basel standards in LICs and LMICs, and whether and to what extent Basel standards are adapted in the process of implementation. This paper seeks to fill that gap in the scholarship.

The study thus focuses on the following elements of Basel adoption in LICs and LMICs:

- the speed of Basel standards adoption by LICs and LMICs,
- which elements of the Basel standards they adopt,
- any tailoring of the standards to the national context,
- the governance arrangements under which LICs and LMICs implement the standards, and
- the structural independence from the ruling or banking elite of those charged with deciding whether to implement the standards.

To examine these elements of Basel adoption, I developed four case studies from a subset of countries which have been particularly active in implementing Basel standards: LICs and LMICs which have already begun adopting Basel III, the 2010 accord. The case studies look at the implementation of Basel I, II and III.[5]

Per the 2015 FSI Basel Implementation Survey, LIC and LMIC countries implementing Basel III are: Bangladesh, Kenya, Zimbabwe, Liberia, Morocco, Egypt, Georgia, Nigeria, Pakistan,

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[3] Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom and United States.
[4] Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.
[5] Basel II.5, issued in 2009, focuses on sophisticated financial markets. Accordingly, it is largely irrelevant to LIC and LMIC contexts and is not covered in this study.

the Philippines, and Sri Lanka (n=11). I developed case studies of Bangladesh, Kenya, the Philippines and Sri Lanka (n=4). I chose this sample because only these countries had high quality, relatively comprehensive, English language data available online. Fortuitously, the sample shows a range of implementation strategies, from full implementation in Bangladesh to extremely limited implementation in Sri Lanka. It also shows a spectrum of governance structures for Central Banks.

It is important to appreciate that this research looks at the enactment of elements of the Basel accords in LICs and LMICs, rather than the extent of implementation after the regulations are in place. Further, it examines the legal structures of decision-making bodies and their relationship to government, rather than the way those relationships are navigated in practice. Research of that kind would require qualitative data from a variety of participants in each examined banking jurisdiction, collection of which is beyond the scope of this paper.

Sources and methods

This paper was written using sources drawn largely from the websites of the subject countries' regulators.[6] While the preferred way to conduct legal research is through authorised legislation[7] and regulations,[8] these materials were not translated and/or digitised. Accordingly, I relied largely on materials reported on the relevant Central Bank's website, including the copies of enabling legislation provided on those websites and events reported in annual reports. While I conducted general internet searches to confirm the currency of legislation and regulations cited in this paper, I cannot affirm that the instruments relied on are current or accurate. Guidelines and circulars have been downloaded from a website maintained by the Central Bank that issued them, and therefore do not carry the same caveat.

Each of the case studies describes the country's implementation trajectory, sets out which aspects of Basel it has implemented or modified, comments on the decision-maker/s charged with implementing Basel, outlines the legal mechanisms which enable implementation. This summary section follows that structure, providing a general summary of the research findings across the four case studies.

[6] See, generally, Bangladesh Bank (Central Bank of Bangladesh): https://www.bb.org.bd/; Central Bank of Kenya: https://www.centralbank.go.ke/; Bangko Sentral ng Pilipinas (Central Bank of the Republic of the Philippines): http://www.bsp.gov.ph/; Central Bank of Sri Lanka: http://www.cbsl.gov.lk/; South African Reserve Bank (Central Bank of South Africa): https://www.resbank.co.za/.

[7] Meaning legislative instruments promulgated by Parliament.

[8] Meaning implementing instruments promulgated by the Executive.

Table summary of findings

	Basel I year	Basel II year	Basel III year	Basel II: Internal modelling allowed?	Minimum capital requirement	Other Basel III elements adopted	Decision-maker (DMR)	Implementation method	New legislation required?	Structural independence of DMR (ranked)
Basel members	1988	2006	2010-19	Yes	4.5% of RWA in CET1, 6% in core capital, 8% in total capital	See "international level" section.	Various	Various	Various	Various
Kenya	1999	2012	2012	Yes, for operational risk, only w approval by CBK	8% of RWA in core capital, 12% in total capital	CCB (2.5%)	Central Bank + Finance Minister	Guideline	Yes, for consolidated supervision only	◆◆◆◆
Bangladesh	2002	2010	2015	No	4.5% of RWA in CET1, 5.5% in core capital, 10% in total capital	Leverage ratio (3%), LCR (>100%), NSFR (>100%)	Central Bank	Guideline	No	◆◆
Philippines	2001	2007/11	2014	Yes, for market risk only	6.0% of RWA in CET1, 7.5% in core capital, 10% in total capital	CCB (2.5%), D-SIBs framework	Central Bank	Guideline	No	◆◆◆
Sri Lanka	Unclear	2008/14	2015	Yes, only with approval by CBSL	5% core capital, 10 % total capital	LCR (60%, progressing to 100% by 2019)	Central Bank	Guideline	No	◆

Key

CBK - Central Bank of Kenya
CBSL - Central Bank of Sri Lanka
CCB - Capital conservation buffer
CET1 - Common equity Tier 1 capital
D-SIBs - Domestic systemically important banks
LCR - Liquidity coverage ratio
NSFR - Net stable funding ratio
RWA - Risk-weighted assets

Implementation trajectories for Basel standards

International level

It is useful at the outset to set out the implementation trajectory for Basel standards at the international level, for international best practice provides a benchmark against which to compare LIC and LMIC implementation trajectories. Basel I, the first capital adequacy accord, was issued in 1988 for implementation by year-end 1992.[9] It was subsequently amended in part by the Market Risk Amendment in 1996.[10] Basel II was issued in 2004, finalised in June 2006 and implemented from 2007, with additional time allowed to developing countries.[11] It has three Pillars: Pillar I relating to minimum capital requirements, Pillar II relating to the supervisory review process and Pillar III on market discipline and disclosure. The advanced approaches in Pillar I were implemented from year-end 2007.

Basel III was issued in 2010.[12] All Basel member countries bar Russia have now implemented Basel II[13] and have begun progressively adopting Basel III, with full implementation required by 1 January 2019. Basel III's capital requirements are immediately effective. The capital conservation buffer (2.5%) and the countercyclical buffer (up to 2.5%) will be phased in from 1 January 2016, becoming fully effective on 1 January 2019. The Basel Committee on Banking Supervision finalised the standardised approach for measuring counterparty credit risk exposures in March 2014, and it will take effect on 1 January 2017. Basel members are testing a Tier I 3% leverage ratio requirement by way of bank-level reporting to national supervisors until 1 January 2015, and implementation and monitoring until 1 January 2017. A final ratio will be decided in 2017 and become effective on 1 January 2018. The liquidity coverage ratio (high-quality liquid assets sufficient to cover total net cash outflows over a 30-day period) will be progressively implemented between 1 January 2015 and 1 January 2019. Further, the final version of the net stable funding ratio (**NSFR**) (a minimum amount of stable sources of funding relative to the liquidity profiles of assets over a one-year time horizon) was released only in October 2014. It will become a minimum standard by 1 January 2018.[14] Finally, the Global Systemically Important Bank (**G-SIB**) and the Domestic Systemically Important Bank (**D-SIB**) frameworks, which impose additional capital charges for the systemic risk posed by significant institutions, will be introduced on 1 January 2016 and become fully effective on 1 January 2019.[15]

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[9] Basel Committee on Banking Supervision, 'International Convergence of Capital Measurement and Capital Standards', (July 1988).
[10] Basel Committee on Banking Supervision, 'Amendment to the Capital Accord to Incorporate Market Risks', (November 2005).
[11] Basel Committee on Banking Supervision, 'Progress Report on the Implementation of the Basel Regulatory Framework', (April 2014).
[12] Financial Stability Board, 'Identifying the Effects of Regulatory Reform on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences', Report to the G20 Finance Ministers and Central Bank Governors, (June 2012).
[13] Basel Committee on Banking Supervision, 'Ninth Progress Report on Adoption of the Basel Regulatory Framework', (October 2005).
[14] The Editors, 'Banknotes', *Central Banking* (2015) 25(3), P9.
[15] Basel Committee on Banking Supervision, 'Ninth Progress Report on Adoption of the Basel Regulatory Framework', (October 2005).

Selected Countries

The Selected Countries tended to implement Basel I around 2000, approximately a decade after it was promulgated. By contrast, each of the Selected Countries moved to implement Basel II shortly after publication by the Basel Committee in 2004. Each implemented Pillar I's capital charges between 2007 and 2010, usually before the other Pillars relating to supervision and market discipline. As the case studies show, the Central Bank was always the critical decision-maker about whether and how Basel standards would be implemented. In all Selected Countries, the Department within the Central Bank charged with international standards implementation first began a consultative process with industry about Basel implementation, conducting quantitative impact studies and, sometimes, stress testing of the new provisions. This process took at least two years. Regulators then generally implemented the standards via a parallel run to allow financial institutions to adjust to the new reporting requirements and to naturally accumulate requisite capital. Indeed, in Sri Lanka a 12-month phase-in period is legally required where a new guideline requires a financial institution to hold higher levels of capital. Overall, sufficient capitalisation was not a major concern in the Selected Countries – each study showed banks to be already operating in excess of the Basel ratios on average.

The supervisory review process required by Pillar II took longer to implement everywhere but Bangladesh (where it was adopted in 2010), entering into force in the Philippines in 2011, in Kenya in 2013 and in Sri Lanka in 2014. I speculate that this is attributable to capacity building needed within both banks and the Central Bank to adopt a new reporting framework. The Selected Countries have also been very active in implementing Basel III, which Basel member countries will only fully implement in 2019. In general, the Selected Countries have made the capital requirements immediately effective, and implemented other provisions progressively. This staged implementation is consistent with the approach taken by the Basel Committee members as described above.

Particular elements of the implementation trajectory of some Selected Countries bear mention. Kenya's Central Bank has been particularly active in pushing consolidated supervision of international financial institutions, executing various Memoranda of Understanding with other regulators and convening supervisory colleges focused on specific banks to this end. This strategy is one approach that jurisdictions supervising several international institutions can take. Kenya has also stated that it intends to harmonise its implementation with other members of the East African Community, which is likely to hold back its implementation of some of Basel III's more controversial elements, such as the liquidity coverage ratio. In this sense, researchers should consider not only national approaches to Basel implementation, but also the influence of regional co-operation bodies.[16] Bangladesh should be watched by researchers, for it has almost exactly adopted the implementation plan of a Basel Committee member and will provide a case study of the impact of 'off-the-shelf' standards in a LIC context. Finally, of the Selected Countries, only the Philippines created an explicit carve out for banks with unsophisticated operations. This, too, is a strategy that LICs and LMICs now considering adopting Basel might consider.

[16] Unfortunately for present purposes, the East African Community had not published policy documentation regarding its approach to Basel standards online. There are no digitised, English language reports of the Monetary Affairs Committee's work since 2011.

Implemented elements of Basel I, II and III and relevant modifications

As the case studies demonstrate, each Selected Country is heterogeneous in those elements of Basel it has implemented. Bangladesh has implemented Basel III 'off the shelf', with the exception of the countercyclical buffer. Sri Lanka, on the other hand, has adopted only the liquidity coverage ratio from Basel III, and promulgated a bespoke phase-in timetable in doing so. However, despite this heterogeneity, three clear trends in LIC and LMIC implementation of Basel emerge from this research. First, Selected Countries tend to implement basic capital requirements which are higher than those Basel requires, at a margin of about 2% extra (see, e.g., the Philippines' minimum capital adequacy ratio of 10%, cf Basel III's required 8%). Second, Selected Countries have chosen the simplest methods of risk assessment Basel II offers, permitting banks to use advanced internal model based risk calculation mechanisms solely with approval. Unfortunately, no information is available online about whether, how often and under what conditions approval has been granted. One exception is the Philippines' approach to market risk, which permits all banks to use the internal modelling approach provided various aspects of the methodology are disclosed in the bank's annual reporting. Third, even among these countries selected as early adopters, elements of Basel III that require high levels of supervisory infrastructure, such as the D-SIBs framework, are generally implemented later.

Governance structures and legislative implementation in Selected Countries

As stated above, the Boards of Central Banks in the Selected Countries, and their Governors, are the primary decision-makers in implementing Basel standards in the LICs and LMICs studied. These regulators had varying degrees of structural independence from Government. I measured structural independence by examining from a legal perspective the independence of the Board appointment process, the presence of government officials on the Board, term limits, restrictions on removal by Government and fitness for office requirements. Applying these criteria, Kenya's Central Bank Board is the most independent, with a transparent appointment process, strict fitness requirements and only one Government representative on the eleven-member Board, which representative does not have voting powers. By contrast, the Central Bank of Sri Lanka is the least structurally independent of the Selected Countries, with its Board being comprised of four Ministry of Finance appointees and the Secretary of the Ministry of Finance. Yet even this structure presents a sharp contrast from, for example, South Africa, a Basel member, where an official called the Registrar of Banks appointed by the Finance Minister and separate from the Reserve Bank Board has full responsibility for implementation.[17]

In the Selected Countries, Basel standards were implemented by regulators issuing binding guidelines, which are sometimes, but not always, codified into formal legislation. The case

[17] Banks Act 1990, s 4.

studies below show that Basel implementation does not necessarily require Parliament to afford regulators new powers. Central Banks in the studied LICs and LMICs had ample and overlapping legal powers to give general and specific directions to financial institutions about capital adequacy and supervisory requirements. One notable exception was Kenya, which amended its legislation explicitly to enable the Central Bank to engage in consolidated supervision. Central Banks in the studied LICs and LMICs also had ample and significant powers to request information and otherwise enforce Basel standards. For example, the Central Bank of the Philippines can restrict access to inter-bank settlement mechanisms for non-compliant financial institutions, a robust power that would be highly unlikely to have a parallel in a developed country bank without the presence of significant safeguards. In general, Basel members likely have similar processes of implementation to these countries. For example, in South Africa (a Basel member State) the accords are implemented by directive and then formalised via the Regulations relating to Banks.[18] Further, the Registrar for Banks is a member of the Standing Committee for the Banks Act, which frequently reviews the Banks Act and the Regulations to ensure the South African Reserve Bank has sufficient legal powers to perform its mandate.[19]

[18] Banks Act 1990, s 4.
[19] International Monetary Fund and the World Bank, 'South Africa – Basel Core Principles for Effective Banking Supervision: Detailed Assessment of Compliance', (October 2010), https://www.imf.org/external/pubs/ft/scr/2010/cr10353.pdf, P10.

Kenya

Implementation trajectory

Kenya implemented Basel I in 1999, 11 years after it was promulgated.[20] The Central Bank of Kenya (**CBK**) continues to regulate banks largely based on Basel I.[21] Unfortunately, no digitised information is available about the implementation process from this time period. In 2005, immediately following Basel II's publication, the CBK published a road map toward Basel II implementation. However, the consultative forum of the Monetary Affairs Committee (MAC) of the East African Community resolved that East African Central Banks would only implement Basel II after full implementation of Basel I, compliance with the Basel Core Principles for Effective Banking Supervision and capacity building measures.[22] Kenya achieved these benchmarks in 2007.

In September 2007, the CBK therefore issued an Information Memorandum on Basel II implementation to the banking sector. The covering letter stated that 'a consultative approach with relevant market players will be adopted in formulating the Basel II policy position' and that a policy position was expected to be formulated in 2008.[23] At this time, the Banking Act was also reviewed by CBK in consultation with the Ministry of Finance and the Kenya Bankers Association. The review, which concluded in May 2007, proposed amendments to ensure consistency with best international practices including Basel II.[24] In my view, is unusual for an independent Central Bank to lead such a review, rather than the Ministry of Finance or a Parliamentary Committee. The amendments proposed were passed as the Finance Act 2008 on 15 December 2008, and entered into force on 1 January 2009. Relevantly for this paper, the Finance Act 2008 progressively raised the minimum core capital for banks from Ksh 250 million to Ksh 1 billion by 2012.[25]

Ultimately, Kenya implemented elements of Basel II only four years later, simultaneously with Basel III. The method of implementation for elements of Basel II and III in 2012 was the issuance of revised Prudential and Risk Management Guidelines by the CBK. All relevant provisions entered into force on 1 January 2013, with a transition period until 1 January 2015 for the capital conservation buffer.[26]

In implementing Basel standards, the CBK has made a significant effort to engage with regional regulators to engage in effective consolidated supervision. It has entered Memoranda of Understanding calculated to promote cross-border banking supervisory

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[20] Prof Njuguna Ndung'u, 'Implementation of Basel II, Risk Management Framework within Banks and the Prevention of Financial Crime' (Address at the opening of the 7th East African Banking School, Nairobi, 20 August 2007).
[21] Francis M Mwega, 'Financial Regulation in Kenya: Balancing Inclusive Growth with Financial Stability', (Overseas Development Institute Working Paper 407, November 2014) P27.
[22] East African Community Monetary Affairs Committee, 'Achievements, Challenges and Way Forward', P23; Central Bank of Kenya, Banking Supervision Report, (2007), Piii.
[23] Central Bank of Kenya, Banking Supervision Report, (2007), P51-52.
[24] Professor Njuguna Ndung'u, 'Banking Sector Developments in Kenya' (Address at the opening of the Nakuru Branch of Fina Bank Limited, Nakuru, 26 July 2007).
[25] Central Bank of Kenya, Banking Supervision Report, (2008), P36; Francis M Mwega, 'Financial Regulation in Kenya: Balancing Inclusive Growth with Financial Stability', (Overseas Development Institute Working Paper 407, November 2014), P27.
[26] Central Bank of Kenya, Banking Supervision Report, (2012).

cooperation with the Central Banks of South Africa (2010), South Sudan (2012), Malawi, Zambia and Zimbabwe (2013) and India (2014).[27] Their purpose is 'to ensure regulators provide relevant information to each other regarding material developments or supervisory concerns with respect to particular financial institutions and respond to information requests on their supervisory systems.'[28] In this spirit, as at 2014 CBK has also established six 'supervisory colleges' focussed on particular international banking groups for the purpose of producing effective consolidated supervision. Those banking groups are: the KCB Group, Diamond Trust Bank, Equity Bank, I&M Bank, Commercial Bank of Africa, and NIC Bank.[29]

Implemented elements of Basel I, II and III and relevant modifications[30]

As noted above, the Bank issued revised Prudential and Risk Management Guidelines in 2012, which entered into force on 1 January 2013. These Guidelines implement some, but not all of the Basel II and III model regulations. The Guidelines also modify some of the Basel III regulations. They apply to banks, financial institutions and mortgage finance companies licensed to conduct banking business in Kenya under the Banking Act.[31]

From Basel II, the Guidelines introduce capital charges for credit, market and operational risk. For credit risk, the CBK applies capital charges consistent with the standardised measurement approach, unless the CBK has approved an institution to use an internal ratings-based approach.[32] For market risk, all institutions must adopt Basel II's standardised approach, unless the CBK has approved the institution to use an internal models approach.[33] Finally, for operational risk, the CBK prescribes a 15% holding requirement using the basic indicator approach, consistent with Basel II.[34] While the CBK encourages institutions to adopt more advanced approaches as they develop more sophisticated operational risk management practices, these will be subject to CBK approval. In its 2014 Banking Supervision Annual Report, the CBK noted that the non-sophisticated nature of the Kenyan banking sector drove its choices to allow the use of internal models only with approval.[35] The CBK granted institutions a year-long adjustment period in relation to capital charges for market and operational risk, which only entered into force on 1 January 2014.

On Basel III, the CBK's Guidelines do not adopt Basel III's requirement that banks hold Common Equity Tier I capital of 4.5% of Risk Weighted Assets (**RWA**), Tier I capital of 6% of

[27] Central Bank of Kenya, Banking Supervision Reports, (2010-14).
[28] Central Bank of Kenya, Banking Supervision Report, (2014), P41.
[29] Central Bank of Kenya, Banking Supervision Report, (2014), P41-42.
[30] The following data is largely consistent with Kenya's reporting to the 2015 FSI Basel Implementation Survey. However, Kenya's FSI submission states that the CBK has implemented the Basel regulation focusing on D-SIBs and, indeed, the reports discussed above regarding Kenya's coordination of international supervision of regionally significant banks suggests this is so. However, formal implementation of Basel's D-SIBs framework was not present in the 2013 Guidelines or the contemporaneous amendments to the Banking Act.
[31] Central Bank of Kenya, Prudential Guidelines, (2012), P83.
[32] Central Bank of Kenya, Prudential Guidelines, (2012), P87.
[33] Central Bank of Kenya, Prudential Guidelines, (2012), P87.
[34] Central Bank of Kenya, Prudential Guidelines, (2012), P97.
[35] Central Bank of Kenya, Banking Supervision Report, (2013), P43.

RWA and total capital (Tier I and Tier II capital) of 8% of RWA. Rather, CBK has instituted a higher requirement: a core capital of not less than 8% of total risk adjusted assets plus risk adjusted off balance sheet items; a core capital of not less than 8% of total deposit liabilities; and a total capital of not less than 12% of total risk adjusted assets plus risk adjusted off balance sheet items. The Guidelines adopt the capital conservation buffer of 2.5%, providing that institutions were required to meet it with high quality capital by 1 January 2015.[36] This deadline gave banks two years to build up their capital conservation progressively, rather than suddenly.[37] Basel III's liquidity coverage ratio and NSFR are set out in the 2013 Risk Management Guidelines. In Kenya's submission to the Financial Stability Institute's 2015 Basel Implementation Survey, the CBK states that that Basel III's liquidity coverage ratio will enter into force by 31 December 2016 and the NSFR by 31 December 2018, based on the proposed East African Community regulatory and supervisory criteria.[38] Until then, financial institutions must maintain a statutory minimum of twenty per cent (20%) of all its deposit liabilities, matured and short-term liabilities in liquid assets.[39] Given the international trajectory outlined above, this timeline puts Kenya two years behind Basel Committee members in beginning implementation of the liquidity coverage ratio and one year behind in relation to the NSFR. So far, Kenya has not implemented Basel III's leverage ratio, the risk coverage provisions or the counter-cyclical buffer provisions. However, Kenya's 2015 FSI submission states that, consistent with an agreement by the East African Community Central Banks, it expects to bring the leverage ratio into effect by 31 December 2016.

Relevant decision-makers and enabling legislation

The CBK, the Minister of Finance and Parliament are each decision-makers in relation to Basel implementation in Kenya. However, the CBK and its Governor are the most important decision-makers, for they determine supervisory policy and, as shown above, Basel implementation in Kenya has been achieved by the CBK issuing binding guidelines, rather than by legislation. It is therefore important to examine the extent to which the CBK's leadership is structurally linked to Government and the powers it has to implement Basel standards.

The CBK is relatively independent from the Government in terms of both its leadership's independence and capacity to act, and its resources. Parliament has vested the CBK with broad central banking powers[40] and a specific mandate to foster 'the liquidity, solvency and proper functioning of a stable market-based financial system'.[41] CBK's Board of Directors is responsible for determining Bank policy and its Governor is responsible for management of the Bank.[42] Appointment to the eleven-member Board, which is responsible for determining

[36] Central Bank of Kenya, Prudential Guidelines, (2012), P88.
[37] Central Bank of Kenya, Banking Supervision Report, (2013), P43.
[38] Central Bank of Kenya, Risk Management Guidelines, (2012), P32-39; Financial Stability Institute, Survey on Basel Implementation, (2015), P49.
[39] Central Bank of Kenya, Risk Management Guidelines, (2012), P33.
[40] Central Bank of Kenya Act, Chapter 491, s 3(3), under which the CBK is established and may exercise 'any type of central banking function unless specifically excluded under the Central Bank of Kenya Act, and shall enjoy all the prerogatives of the central bank'.
[41] Central Bank of Kenya Act, Chapter 491, s 4(2).
[42] Central Bank of Kenya Act, Chapter 491, s 10(a), 13. By s 12A (amended in 1996), the Board can make general or specific delegations of its powers.

Bank policy, is relatively disassociated from Government.[43] Voting Board members (the Chairperson, the Governor and eight non-executive directors) must be appointed by the President through a transparent and competitive process with the approval of Parliament. Terms last four years, and Board members may be re-appointed for one further term only.[44] Board members can only be removed if they no longer meet the criteria for office (for example, they become elected official), become bankrupt, are convicted of an offence involving dishonesty or moral turpitude, are declared of unsound mind or a three member Panel composed of judges or former judges of the High Court or the Court of Appeal declare them otherwise incapable of performing their duties.[45] The only Government representative on the Board is the Permanent Secretary to the Treasury or the Secretary's representative, who sits as a non-voting member.[46] By way of rough comparison, this appointment structure is similar to that of the United States Federal Reserve Board, which relies on a Presidential nomination and Parliamentary approval. The term limits, however, are longer (fourteen years cf four years) and Government is not represented in Board meetings.[47] From a capacity point of view, the CBK is supported by a Banking Supervision Department, which had 63 technical staff in 2013.[48] It thus is able to conduct the consultative processes necessary to evaluate whether and how to implement Basel standards.

Under the Banking Act, Chapter 488, the CBK has specific powers to issue binding directives to implement minimum capital requirements and banking supervisory policy. These powers show the CBK is the designated institution for implementing Basel reforms. On capital adequacy, section 18 empowers the CBK to 'prescribe the minimum ratios which shall be maintained by institutions and banking groups as between their core capital and total capital on one hand and their risk weighted assets (including their total loans and advances) and risk-weighted off balance sheet items on the other and for that purpose, may also determine the method of classifying and evaluating assets'. The CBK also has discretion to prescribe higher minimum ratios based on its assessment of a relevant institution or banking group's risk profile. Section 19 states that any institution shall maintain such minimum holding of liquid assets as the CBK specifies from time to time. CBK directives apply equally to holding companies or other vehicles of ownership of banking institutions. On bank supervision, s 33 empowers the CBK to advise and give binding directions to institutions where it has reason to believe the institution is contravening or may contravene the Banking Act or the best interests of depositors. Subsection (4), amended in 2012 to support the new Prudential and Risk Management Guidelines, authorises the CBK to engage in consolidated supervision.

For completeness, I note that the Banking Act also affords the CBK adequate information gathering and enforcement powers. Sections 21, 27 and 28 empower the CBK to direct an institution to provide existing information, to submit periodic returns and to furnish any information reasonably required for the discharge of its functions, enabling the CBK to request information in a timely fashion and to adjust the reporting it demands from time to time. By s 34 of the Banking Act, the CBK can restrict the activities and interfere in the

[43] Ibid.
[44] Central Bank of Kenya Act, Chapter 491, ss 11 and 13.
[45] Central Bank of Kenya Act, Chapter 491, s 14.
[46] Central Bank of Kenya Act, Chapter 491, s 10(a).
[47] Federal Reserve Board, 'Structure of the Federal Reserve System: The Board of Governors', (2003): http://www.federalreserve.gov/pubs/frseries/frseri.htm.
[48] Central Bank of Kenya, Banking Supervision Report, (2013), PP1-2.

management of institutions which are found to be undercapitalised. By s 49, contravening the Banking Act is an offence carrying a maximum fine of Ksh 100,000 (for bodies corporate).

Parliament and the Minister of Finance are also decision-makers in relation to Basel implementation. This is because they must approve changes to supervisory policy that require legislative amendment. Further, Parliament is more generally able to overrule the Guidelines by legislation at any time. This is because if the Guidelines, a piece of subordinate legislation, were inconsistent with the Banking Act, a piece of legislation proper, the Banking Act would prevail. Relevantly for present purposes, the Banking Act specifies that an institution cannot be licensed to carry on banking activities unless it meets the minimum capital requirements in Schedule 2, which mirror those the CBK sets out in the Prudential Guidelines, as well as the Ksh 1 billion minimum capital amount that Kenya enacted in 2008.[49] The present minimum capital provisions cannot be reduced or refined without the sanction of the Minister of Finance and Parliament. This is because s 7(2) authorises the Finance Minister – not the CBK – to amend Schedule 2 by order published in the Gazette. Any order made under this provision will be put before the National Assembly 'without unreasonable delay' and unless it is approved within 20 days following its next sitting it shall be void. It is interesting to observe that the Government chose to update Schedule 2 to reflect the 2013 CBK Guidelines. The Guidelines themselves are legally binding, so updating the Banking Act to reflect present capital adequacy requirements is an additional and voluntary step toward implementation, rather than a necessary one. Its effect is to entrench the present standards by requiring three decision-makers – Parliament, the Finance Minister and the CBK – to change them in future.

[49] Banking Act, Chapter 488, s 7.

Bangladesh

Implementation trajectory

Bangladesh began implementing Basel I in 2002, thirteen years after Basel I was issued. Unfortunately, there is no digitised information about this implementation process. In 2005, a National Steering Committee and a Coordination Committee began work on Basel II implementation, immediately following Basel II's publication. The Bangladesh Bank (Bangladesh's central bank) completed a self-audit and study of banks operating in the jurisdiction in October 2006. The Basel II implementation cell of the Bank's Banking Regulation and Policy Department conducted the study. It showed that Basel II could be implemented and Risk Based Capital Adequacy Guidelines implementing Basel II entered into force 1 January 2010, following a year-long parallel run with Basel I during which banks began quarterly reporting under Basel II.[50]

To assess the preparedness of banks for implementing Basel III in Bangladesh, Bangladesh Bank (**BB**) conducted two consecutive quantitative impact studies in 2013 and 2014.[51] The Bank decided it would fully implement Basel III, beginning on 1 January 2015, stating that the studies showed a 'propitious condition in quality and level of capital for phasing in arrangement of Basel III'. Unfortunately, more fulsome accounts of the studies' findings were not available online. However, it is clear that ensuring that banks can accumulate high-quality capital was not a major regulatory concern, as Tier I Capital was nine percent of RWA on average in Bangladeshi financial institutions in 2013.[52] All elements of Basel III will be implemented by 1 January 2019, with some provisions entering into force earlier than others.

Implemented elements of Basel I, II and III and relevant modifications[53]

In 2010, Bangladesh adopted Basel II's standardised approach for calculating RWA against credit risk supported by External Credit Assessment Institutions (**ECAIs**), standardised rule

[50] Chowdhury et al, Bangladesh Bank, 'Guidelines on Risk Based Capital Adequacy: Revised Regulatory Capital Framework for Banks in line with Basel III', (2014), P1; Hassan, Bangladesh Bank, 'Banking Regulation and Policy Department Circular No 9', (2014).
[51] Chowdhury et al, Bangladesh Bank, 'Guidelines on Risk Based Capital Adequacy: Revised Regulatory Capital Framework for Banks in line with Basel III', (2014), Pv.
[52] Bangladesh Bank, 'Financial Stability Report', (2013).
[53] The data which follows is consistent with Bangladesh's reporting to the 2015 FSI Basel Implementation Survey in all but two respects. First, on Basel II, Bangladesh notes that it published a draft rule for assessing operational risk by a standardised/alternative standardised approach, rather than the basic indicator approach, in 2008. Since then, it has promulgated Guidelines on the use of the basic indicator approach and continued to approve credit ratings agencies. This suggests that the implementation of a different approach is unlikely, and this data point can be properly ignored. Second, on Basel III, Bangladesh states that Basel III's liquidity coverage ratio, the definition of capital, the capital conservation buffer and the leverage ratio are in force as at 2015. However, Basel III's capital conservation buffer does not enter into force in any form until 2016, and then will only be fully implemented by 2019.

based approach against market risk and basic indicator approach for operational risk, along with the supervisory processes in Pillars II and III.[54] In March 2010, the BB increased the capital adequacy ratios[55] from Basel II's required 8% of risk weighted assets to 9% from 1 July 2010 to 30 June 2011, and 10% from 1 July 2011 onward.[56] Further, BB prescribed that at least 50% of the minimum capital requirement must be Tier I capital components, which requirement is not present in Basel II. These changes were achieved by the BB issuing binding directions under the Banking Company Act 1991. Although the initial roadmap for Basel II implementation envisaged offering the use of internal models or ratings-based methodologies with approval by 2012, I did not locate subsequent circulars implementing this intention.[57]

The final significant change made by BB in its implementation of Basel II was issuing a comprehensive credit rating methodology for loans to small and medium enterprises (**SMEs**) in 2014 because 'credit risk assessment in this segment requires a specific approach'.[58] Basel II and III's push for banks to hold high-quality capital risks contracting the credit available to SMEs, an anomalous outcome in LICs and LMICs where SME loans may in fact be less risky than other asset classes.[59] This risk is greater where ratings agencies in LICs and LMICs do not assess SME loans, putting them in the 100% risk category. Thus BB's Guidelines, along with its approval of eight ECAIs which offer ratings for SME loans, can be seen as a response to this issue.

The Guideline on Basel III states that 'full implementation of Basel III' is planned by January 2020.[60] However, the Guideline does not incorporate provision for a countercyclical capital buffer, despite setting out the reasoning behind this measure within its introduction.[61] Further, the guidelines do not incorporate Basel III's risk coverage provisions, notably the new credit valuation adjustment risk capital charge. However, Bangladesh's financial markets are likely not sufficiently sophisticated to warrant enactment of the risk coverage provisions. Of the provisions Bangladesh is implementing, there are no modifications to the model regulations the Basel Committee proposes, other than those carried over from Basel II above, notably the absence of an option to use internal modelling to calculate capital charges. The below table summarises Bangladesh's phase in period:[62]

[54] Bangladesh Bank, 'Guidelines on Risk Based Capital Adequacy: Revised Regulatory Capital Framework for Banks in line with Basel III', (2010).
[55] Calculated as (Eligible regulatory capital/RWA x 100).
[56] Wadood, Bangladesh Bank, 'Banking Regulation and Policy Department Circular No 10', (2010).
[57] Banking Policy and Regulation Department, Bangladesh Bank, 'Circular No 14, Implementation of New Capital Accord (Basel II) in Bangladesh', (December 2007).
[58] Banking Regulation and Policy Department, Basel II Implementation Cell, Bangladesh Bank, 'Credit Rating Methodology for Small and Medium Enterprise', (2014).
[59] Financial Stability Board, 'Identifying the Effects of Regulatory Reform on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences', Report to the G20 Finance Ministers and Central Bank Governors, (June 2012), P32.
[60] Chowdhury et al, Bangladesh Bank, 'Guidelines on Risk Based Capital Adequacy: Revised Regulatory Capital Framework for Banks in line with Basel III', (2014).
[61] Ibid, P2-3.
[62] Ibid, P4.

Table 1: Phase-in arrangements for Basel III implementation in Bangladesh

	2015	2016	2017	2018	2019
Minimum Common Equity Tier 1 (CET1) Capital Ratio	4.50%	4.50%	4.50%	4.50%	4.50%
Capital Conservation Buffer	-	0.625%	1.25%	1.875%	2.50%
Minimum CET1 plus Capital Conservation Buffer	4. 50%	5.125%	5.75%	6.375%	7.00%
Minimum T-1 Capital Ratio	5.50%	5.50%	6.00%	6.00%	6.00%
Minimum Total Capital Ratio	10.00%	10.00%	10.00%	10.00%	10.00%
Minimum Total Capital plus Capital Conservation Buffer	10.00%	10.625%	11.25%	11.875%	12.50%
Phase-in of deductions from CET1					
Excess Investment over 10% of a bank's equity in the equity of banking, financial and insurance entities[2]	20%	40%	60%	80%	100%
Phase-in of deductions from Tier 2 Revaluation Reserves (RR)[3]					
RR for Fixed Assets, Securities and Equity Securities	20%	40%	60%	80%	100%
Leverage Ratio	3%	3%	3% Readjustment	Migration to Pillar 1	
Liquidity Coverage Ratio	≥100% (From Sep.)	≥100%	≥100%	≥100%	≥100%
Net Stable Funding Ratio	> 100% (From Sep.)	>100%	>100%	>100%	>100%

Thus Bangladesh's phase-in arrangements mirror, and in the case of the liquidity coverage ratio and the NSFR exceed, those that Basel Committee members are following.

Legislative process and relevant decision-makers (including sources of delegated authority)

The BB, in particular its Banking Regulation and Supervision Department, is fully responsible for the implementation of Basel III by way of binding guidelines. Basel's mandate is squarely among the Bank's main functions: to 'regulate and supervise banking companies and financial institutions' and to 'propose legislative measures [to Government] it considers necessary and appropriate to attain its objectives and perform its functions'.[63] It is thus relevant to look at the Bank's structural independence from Government. The eight-member Board of Directors includes three government officials who serve at the Government's pleasure, and four persons nominated by the Government who, in the opinion of the Government, 'have had experience and shown capacity in the field of banking, trade, commerce, industry or agriculture' and who serve three-year renewable terms. The Governor and Deputy Governor are also nominated by the Government to serve four-year renewable terms.[64] Governors and Deputy Governors must meet certain standard fitness for office requirements (eg, no criminal convictions, no conflicts of interest), however these do not apply to the other Board members. Further, the Government may remove any Board Member from office if 'he becomes permanently incapable of performing his duties or subject to a disqualification, … has done any act which is a breach of the trust reposed in him, or if

[63] Presidential Order No 127 of 1972, s 7A (c) and (f).
[64] Presidential Order No 127 of 1972, s 9-10.

his continuance in office is regarded as manifestly opposed to the interests of the Bank'.[65] These subjective criteria leave the Board quite vulnerable to sanction by Government. Thus the BB has significantly less structural independence from Government than, for example, its Kenyan counterpart. However, it has both a designated Banking Policy and Regulation Department and implementation cells within that Department, suggesting a high level of implementation capacity. Information about the staffing or budget of the Department was not available to me.

The BB has wide powers to determine and amend Bangladesh's capital adequacy and supervisory regime from time to time. The Bank Companies Act 1991 (**BCA**) permits the BB to determine what banks' Paid up Capital, Reserves and Cash Reserve must be.[66] Section 45 of the BCA gives BB authority to issue binding directions on banks generally or a specific bank for four reasons: where it is satisfied that it is in the public interest, to provide for the improvement of the monetary or banking policy, to prevent the affairs of the banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company, or to secure the proper management of any banking company. This power enables BB to implement the Basel III capital adequacy and supervisory regime by issuing guidelines. In 2013, legislative amendments to the BCA expanded s 45 to apply to state owned banks and specialised banks, expanding BB's sphere of influence. The Presidential Order which established the Bank also provides it with broad powers to execute its mandate. Section 16(26) empowers the Bank to do all things necessary, incidental or consequential upon the exercise of its powers or the discharge of its duties under the Order or any other law. By section 81, the Bank is obligated to adopt policies and remedial measures when monetary stability is threatened and to give a comprehensive report to Government. Notably, in 2010, the IMF criticised the Order as not allowing the BB to proactively plan for anticipated changes in market conditions or adverse events by requiring banks to adopt a forward-looking approach in setting capital levels.[67] However, in my view, s 81 of the Order, combined with the power under s 45 of the BCA to issue binding directions is sufficient for this purpose. Indeed, BB could adopt a countercyclical buffer under this legislation without the need for a further grant of power.

Bangladesh's legislation also provides for enforcement of Basel standards. If a bank fails to meet the minimum capital amount for the capital adequacy ratio within the stipulated period, BB may impose a fine under s 13(7). Knowingly furnishing false information in reporting to BB is an offence under s 109(2). Further, failure by a bank to report to BB without a satisfactory reason empowers BB to impose a penalty under s 109(7) of the BCA.

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[65] Presidential Order No 127 of 1972, s 15.
[66] Sections 13(2) and 25. Note that these provisions were amended in 2013, but only to remove pre-existing minimum amounts and so expand the Bank's jurisdiction.
[67] International Monetary Fund, 'Bangladesh: Financial System Stability Assessment', (February 2010), P39.

Philippines

Implementation trajectory

The Philippines, via the Bangko Sentral ng Pilipinas (**BSP**), its Central Bank, adopted Basel I in 2001[68] and Basel II between 2007 and 2011. Pillars I and III of Basel II, concerning minimum capital requirements and market discipline, took effect on 1 July 2007.[69] Pillar II of Basel II, concerning the supervisory review process, took effect on 1 January 2011 for commercial banks (**U/KBs**) at a consolidated level only. Supplementary guidelines for Philippine branches of foreign banks were issued on 28 July 2011.[70] Stand-alone thrift banks, rural banks and cooperative banks that are not subsidiaries of commercial banks are subject to a simplified version of Basel II that entered into force on 1 January 2012. These guidelines were crafted by the BSP 'in view of the simple operations of these covered banks.'[71]

On 10 January 2011, the BSP set the stage for Basel III implementation by adopting minimum eligibility criteria for inclusion as qualifying capital – beginning a phase out period for non-qualifying capital that ended in 2015, and which was substantially swifter than some Basel member countries, including the US.[72] The Philippines implemented Basel III on 1 January 2014, following a quantitative impact study in 2012 and a year-long parallel run with the former guidelines.[73] The Guidelines provide that Basel III's capital adequacy requirements apply to subsidiary banks on their own, and as well as to the consolidated entity.[74] Accordingly, subsidiary banks will need to report to both their home regulator (as a member of a consolidated group) and their host regulator, namely the BSP. As at 15 January 2013, stand-alone thrift banks, rural banks, cooperative banks and quasi-banks were excluded from the Basel III regime, continuing to be regulated by bespoke legislation and guidelines.[75]

[68] Circular No 280 dated 29 March 2001.
[69] Circular No 538 dated 4 August 2006.
[70] Circular No 639 dated 15 January 2009. See also Circular 731 dated 28 July 2011 relating to Philippine branches of foreign banks.
[71] Circular No 688 dated 26 May 2010.
[72] Circular No 781 dated 14 December 2012; Circular No 768 dated 21 September 2012.
[73] Circular No 709 dated 15 January 2013.
[74] Circular No 709 dated 15 January 2013, P2.
[75] See also: General Banking Law of 2000, s 71 'Other Banking Laws'.

Implemented elements of Basel I, II and III and relevant modifications[76]

The Philippines implemented Basel I with effect from 1 July 2001 following a three-month phase in period, this 13 years after Basel I was promulgated. BSP imposed a minimum capital requirement of 10% qualifying capital of risk-weighted assets, where discounts applied to lower quality capital. This requirement was in excess of Basel I's required 8%. Further, the BSP did not adopt Basel I's requirement that Tier I capital be 4% at all times. Rather, it developed a system for discounting so called upper Tier II and lower Tier II capital.

In contrast, the BSP adopted Basel II relatively quickly after the Committee published it. From mid-2007, the Philippines implemented Basel II's standardised approach to credit risk, standardised rule-based approach to market risk and basic indicator approach to operational risk. However, the Philippines permits internal modelling for market risk, but not for credit or operational risk. Banks using the internal modelling approach must publish the following information in their annual reports: the characteristics of the models used, a description of the stress-testing applied to the portfolio, a description of the approach used for validating the models' accuracy, the scope of acceptance by BSP, and a comparison of Value-at-Risk estimates with the Bank's actual gains/losses. In 2009, the BSP published its guidelines on Basel II Pillar II: banks' internal capital adequacy assessment process (ICAAP) and the BSP's supervisory review process over ICAAP reporting. The circular did not explain the rationale for implementing Basel II in two parts.

Under Basel III, the BSP has adopted the new categorisation of the capital base, and the 2.5% capital conservation buffer. Tier I is now composed of Common Equity Tier I capital (shown as CET1 below) and additional going concern capital, and subcategories of Tier II capital have been eliminated. However, the BSP decided to adopt higher capital requirements than what Basel III demands, as this table shows:[77]

Capital requirements	Under Basel III		BSP guidelines		
	Minimum ratios	With conservation buffer	Existing minimum ratios	Proposed minimum ratios	Proposed minimum with conservation buffer
a. CET1 ratio	4.5%	7.0%	None	6.0%	8.5%
b. Tier 1 ratio	6.0%	8.5%	5.0% (6.0% as trigger for PCA)	7.5%	10.0%
c. CAR	8.0%	10.5%	10.0%	10.0%	12.5%

[76] There are some inconsistencies between the data outlined in this section and the Philippines' reports to the Financial Stability Institute. As I note in the body of this section, I could not locate some draft regulations alluded to in the Philippines' 2015 response. The FSI data are also somewhat out of date. They record the Philippines having a published draft regulation for implementation of the leverage ratio, whereas it now has a published final regulation. Further, the BSP's framework for assessing D-SIBs is now operational, whereas the survey records it as not yet in force.

[77] BSP, 'Memorandum No M 2012 – 002 Implementation Plans for Basel III Standards on Minimum Capital Requirements', (2012):

In May 2015, the Philippines approved implementation of a Basel III leverage ratio at 5% from 1 January 2017. This is higher than Basel III's recommended 3%.[78] Further, BSP implemented a Basel III-consistent framework for dealing with D-SIBs on 31 December 2014.[79] The higher-loss absorbency requirement for D-SIBs will be phased in from 1 January 2017, with full implementation by 1 January 2019.[80]

The Philippines' submission to the 2015 FSI survey states that it published a draft regulation in March 2013 in relation to the risk coverage provisions, and in March 2015 on the liquidity coverage ratio. However, I could not locate these draft regulations/ circulars, suggesting inaccurate reporting. In its submission to the 2015 FSI Basel Implementation Survey, the Philippines has noted that it is 'not keen' to implement the counter-cyclical buffer element of Basel III.

Legislative process and relevant decision-makers

As in Kenya and Bangladesh, the BSP is the critical decision-maker in the implementation of Basel II and III. Accordingly, its degree of autonomy from the Government is worthy of attention. Formally, the BSP enjoys 'fiscal and administrative autonomy',[81] and has a mandate to 'provide policy directions in the areas of money, banking and credit' and to 'promote and maintain monetary stability'.[82] The BSP's Monetary Board exercises the BSP's powers and functions. The Board is comprised of the Governor, a head of a department whose appointment is subject to confirmation by the Commission of Appointments and six members appointed by the President of the Philippines, including five from the private sector and one member of Cabinet. Most members serve six-year terms and may only be removed for cause, but two private sector appointees are appointed for three years only. Terms may only be renewed once.[83] There are rigorous fitness for office, expertise and conflict of interest requirements for appointment to the Monetary Board.[84] Further, members of the Monetary Board can only be removed for subsequent disqualification from the requirements for office, incapacity which has lasted at least six months, or a finding of guilt in relation to an illegal act or an act which is manifestly opposed to the aims and interests of the BSP.[85] Accordingly, the BSP is relatively independent, however the Government controls appointments and has one of seven voting seats.

The BSP has extremely wide rule making, supervisory and enforcement powers over the banking sector. In particular, it has very robust examination and enforcement powers, which likely do not have counterparts in developed nations.

Section 15 of the New Central Bank Act (1993) relevantly provides that the Monetary Board shall 'issue rules and regulations it considers necessary for the effective discharge of the

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http://www.bsp.gov.ph/downloads/regulations/attachments/2012/m002.pdf. See also Circular No 709 dated 15 January 2013, attaching the Implementation Guidelines for Basel III.
[78] Circular No 881 dated 9 June 2015.
[79] Circular No 856 dated 29 October 2014.
[80] Circular No 856 dated 29 October 2014, P1
[81] The New Central Bank Act (1993); Republic Act No 7653.
[82] The New Central Bank Act (1993), s 3.
[83] The New Central Bank Act (1993), s 6.
[84] The New Central Bank Act (1993), s 8-10.
[85] The New Central Bank Act (1993), s 10.

responsibilities and exercise of the powers vested upon the Monetary Board and the [BSP]. The rules and regulations issued shall be reported to the President and the Congress within fifteen (15) days from the date of their issuance.' Further, s 25 of the Act empowers the BSP to supervise and conduct periodic or special examinations of banking institutions and quasi-banks and their subsidiaries and affiliates engaged in allied activities. This power includes the ability to request information or testimony needed to ascertain the true condition of the examined institution. Section 4 of the General Banking Law of 2000 provides that the operations and activities of banks shall be subject to the supervision of the BSP.[86] 'Supervision', here, includes the establishment of standards, examination of compliance, inquiring into the solvency and liquidity of the institution, and enforcing prompt corrective action. Section 5 of the General Banking Law empowers the BSP to prescribe regulations on bank and quasi-bank practice which conform to international standards, like Basel III. And section 34 explicitly empowers the BSP to prescribe minimum capital adequacy ratios. These provisions enabled the BSP to implement Basel III.

The Philippine legislation and the guidelines implementing Basel III also contain enforcement mechanisms for Basel standards. Under the Guidelines, all breaches of the capital adequacy requirements, even if only temporary, must be reported to the BSP within 3 banking days.[87] Annual reports must disclose full calculations of how the capital adequacy requirements have been met.[88] By s 35 of the Banking Act, knowingly providing a false statement to the BSP is an offence punishable by a fine or imprisonment of up to 5 years. By s 37, the Monetary Board can impose administrative sanctions such as suspension of interbank clearing privileges on financial institutions which wilfully fail to comply with the Act or rules promulgated under it or to conduct business in an unsafe or unsound manner as determined by the Monetary Board.

[86] Republic Act No 8791.
[87] Circular No 709 dated 15 January 2013, P3.
[88] Circular No 709 dated 15 January 2013, P14-16.

Sri Lanka

Implementation trajectory

Unfortunately, there is little data about the implementation of Basel I in Sri Lanka. However, at least since 2008, the minimum capital adequacy requirement for Licensed Commercial Banks (**LCBs**) and Licensed Specialised Banks (**LSBs**) has been 10% in relation to total risk weighted assets with core capital constituting not less than 5% in relation to risk-weighted assets.[89] The Central Bank of Sri Lanka (**CBSL**) implemented Pillar I of Basel II with effect from 1 January 2008, a year after the deadline for Committee members. The supervisory review process under Pillar II of Basel II was implemented in 2014, a delay CBSL attributed to the poor existing internal systems of banks and the need to give them time to adjust to a supervisory regime.[90] In 2015, Sri Lanka implemented limited aspects of Basel III.

Implemented elements of Basel I, II and III and relevant modifications[91]

In 2008, Pillar I of Basel II was implemented with the standardised approach for assessing credit risk, the basic indicator approach for assessing operational risk, and the standardised measurement method for assessing market risk. In 2014, the standardised approach for measuring operational risk was added.[92] The CBSL has stated that it would consider adopting the internal modelling methods in Basel II, but only by approval and only when the necessary infrastructure was in place in both CBSL and the banks.[93]

Commencing from 1 April 2015, every LCB and LSB shall maintain liquidity coverage ratios (**LCRs**) consistent with Basel III's standards as follows:[94]

Effective Date	1 April 2015	1 January 2016	1 January 2017	1 January 2018	1 January 2019 onwards
Minimum Requirement (per cent)	60	70	80	90	100

[89] Since 1 January 2008. See Banking Act Direction No 9 of 2007, Maintenance of Capital Adequacy Ratio.
[90] Central Bank of Sri Lanka, 'Directions, Determinations and Circulars issued to Licensed Commercial Banks', (Inclusive of Amendments made up to 30 November 2013), 5.
[91] The data outlined in this section is completely consistent with Sri Lanka's reports to the 2015 FSI Basel Implementation Survey.
[92] Central Bank of Sri Lanka, 'Directions, Determinations and Circulars issued to Licensed Commercial Banks', (Inclusive of Amendments made up to 30 November 2013).
[93] Jayamaha, 'Basel II – A Roadmap for Sri Lankan Banking System with International Comparisons', (Address to the Association of Professional Bankers, Colombo, 18 December 2006).
[94] Monetary Board for Central Bank of Sri Lanka, 'Banking Act Direction No 1 of 2015: Liquidity Coverage Ratio Under Basel III Liquidity Standards For Licensed Commercials Banks and Licensed Specialised Banks', (31 March 2015).

Full implementation of the LCRs will occur by the Basel deadline of 1 January 2019.

Sri Lanka has not implemented any other aspect of Basel III. The CBSL notes in its submission to the 2015 FSI Survey that its final rules on capital will be issued in 2015. As of 23 October 2015, they have not been issued. The 2013 Financial System Stability Review published by CBSL notes that Sri Lanka is currently in compliance with the new Basel III capital requirements anyway because of its highly capitalised banking sector, making Basel III implementation inevitable but not urgent.[95] The CBSL has also issued a direction stating that LCBs must now increase to a core capital of Rs.10 billion (~46.5 million GBP) by 1 January 2016.[96]

Legislative process and relevant decision-makers

As in the other Selected Countries, the CBSL has been the primary decision-maker in relation to Basel standards in Sri Lanka. Of the Central Banks examined, it is the least structurally independent from the Government. The CBSL is charged with maintaining economic, price and financial system stability.[97] Its powers are exercised by the Monetary Board, which consists of the Governor, the Secretary to the Minister of Finance and three other members, who cannot be members of Parliament or hold positions in financial institutions. The four appointed members shall be appointed by the President on the recommendation of the Minister of Finance and with the concurrence of the Constitutional Council.[98] Appointed members hold office for 6 year renewable terms,[99] and may only be removed on the recommendation of the Minister for Finance for subsequent disqualification from the requirements for office, permanent incapacity, conviction or acts manifestly opposed to the Bank's interests.[100] Thus power is concentrated in a small Board, membership of which has few fitness requirements and is controlled by the Minister of Finance. However, the Monetary Law Act does establish a dedicated and resourced Department of Bank Supervision charged with continuous supervision of banking institutions, whose Director reports to the Monetary Board.[101] In this sense, the technical aspects of Basel implementation likely have relative independence.

The Banking Act No 30 of 1988 accords the CBSL broad powers to issue binding directions on financial institutions, enabling it to implement Basel II and III. Sections 46(l) and 76(J)(1) of the Act respectively empower the Monetary Board of CBSL to issue directions to all or any LCBs or LSBs regarding the manner in which any aspect of the business of such banks is to be conducted. Directions which would require an LCB to change their financial position only take effect after affected institutions are afforded a period of 12 months to comply with the relevant requirement. The implementation of the Basel III liquidity ratio relied on these provisions. In addition, s 19(3) of the Banking Act specifically empowers the Monetary Board

[95] Central Bank of Sri Lanka, '2013 Financial System Stability Review', (June 2014), P5.
[96] Central Bank of Sri Lanka, 'Circular to Licenced Commercial Banks :Enhancement of Minimum Capital Requirement of Banks', (23 December 2014).
[97] Monetary Law Act, Chapter 422, s 5 (version relied on incorporated amendments made up to 30 June 2014).
[98] Monetary Law Act, Chapter 422, s 8.
[99] Monetary Law Act, Chapter 422, s 13.
[100] Monetary Law Act, Chapter 422, s 16.
[101] Monetary Law Act, Chapter 422, ss 25 and 30.

to vary the minimum equity capital required of an LCB to maintain its licence having regard to, inter alia, the viability and stability of the banking system and the interest of the national economy. This provision would support, for example, the implementation of a countercyclical buffer or D-SIB framework.

Sri Lankan legislation also has supporting provisions to enable Basel implementation by CBSL. Section 34 of the Banking Act empowers the Monetary Board to call for any information which it deems necessary to perform its functions, this a substantial power unlikely to be paralleled in a developed country Central Bank without significant safeguards. As with other jurisdictions, the Banking Act provides that non-compliance with directions issued by the CBSL is an offence.[102]

[102] Banking Act No 30 of 1988, s 46(4).